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No. 76-254

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1976

Verit Industries and Marvin Cobb,

Petitioners,

v.

Joe Ohashi

Petition for a Writ of Certiorari to the

United States Court of Appeals

for the Ninth Circuit

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IN THE SUPREME COURT OF THE UNITED STATES

October Term 1976

No.

VERIT INDUSTRIES and MARVIN COBB,

Petitioners,

vs.

JOE OHASHI

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS FOR THE NINTH CIRCUIT

To the Honorable, the Chief Justice, and the Associate Justices of the Supreme Court of the United States,

The petitioner, VERIT INDUSTRIES, respectfully prays that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit, entered in this proceeding on May 25, 1976.

OPINIONS BELOW

The opinion of the Court of Appeals, as yet unreported, appears at Appendix A, infra, page 19. The opinion of the District Court of the Central District of California is unreported, and appears at Appendix B. infra, page 38. The Court of Appeals affirmed part, and reversed part, of the judgment of the District Court.

JURISDICTION

The order of judgment of the Court of Appeals for the Ninth Circuit was entered on May 25, 1976. See Apendix A, page 19, infra. This petition for certiorari was filed less than 90 days from the date aforesaid. The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

QUESTIONS PRESENTED

This case presents the question of

whether a covenant of good faith and fair dealing, implied by state law, can keep an otherwise completed exchange of stock contract executory to provide a sufficient "touching" between the exchange of stock and petitioner's allegedly fraudulent acts to satisfy the "in connection" requirement of the Securities Exchange Act of 1934, Section 10b, 15 U.S.C. Section 78j(b) and S.E.C. Rule 10b-5, 17 C.F.R., Section 240.10b-5. Thus, in 1968, petitioner Verit Industries acquired Commerce-Pacific, Inc., and, as part of the acquisition agreement, respondent Ohashi exchanged his Commerce-Pacific, Inc. common stock for common stock of Verit Industries bearing a restrictive legend. When Ohashi sought removal of the restrictive legend on the stock, more than two years after the exchange of stock pursuant to the acquisition agreement, he allegedly was met with false assurances, misrepresentations,

and inaction on the part of petitioner. Respondent contends these actions violated the federal securities law.

STATUTORY AND RULES PROVISIONS INVOLVED

Section 78j(b) of the Securities and Exchange Act of 1934, 15 U.S.C. Section 78j(b), provides in pertinent part:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange - ...
>
> "(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contra-

vention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5 of the Securities and Exchange Commission, dealing with employment of manipulative and deceptive devices, provides as follows:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of a national securities exchange,

(1) To employ any device, scheme or artifice to defraud,

(2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the

statements made, in the light of the circumstances under which they were made, not misleading, or

(3) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

STATEMENT OF THE CASE

This is an action seeking damages under Section 10(b) of the Securities and Exchange Commission Act of 1934 (15 U.S.C. Section 78j(b) and Securities and Exchange Commission Rule 10b-5 and for common law fraud, conversion, conspiracy, and disparagement.

The allegations of respondent's complaint may be briefly summarized: In August of 1968, respondent became the owner, individually and as custodian for

certain of his children, of 7,784 shares of Verit Industries stock. These shares were subject to a legend restriction which prohibited sale or transfer of these shares unless they were registered with the S.E.C., or exempt from registration.

In December, 1970, respondent conveyed his intention to petitioner that he desired to sell his shares of Verit stock, and he requested petitioner to remove the transfer restriction from his shares. Petitioner then embarked upon a fraudulent scheme to dissuade and prevent respondent from taking any legal action or otherwise, to have the transfer restrictions removed.

The Rulings Below

The District Court ruled (see Appendix B, infra, page 38) that respondent's cause of action based on Section 10b of the Securities and Exchange Act of 1934 (15 U.S.C. Section 78j(b) and Rule 10b-5,

17 C.F.R. 240.10b-5) failed to state a cause of action because respondent was neither a purchaser or seller within the meaning of the Act.

The Court in a Memorandum opinion granting petitioner's motion to dismiss the complaint held that although respondent alleged that he would not have purchased the Verit stock except for the defendant's representation, the allegations of fact indicated that the alleged misrepresentations were first made long after the original purchase. Furthermore, the Court held that since the facts alleged only show that respondent was induced not to sell the stock because of petitioner's representation, respondent could not be a seller within the meaning of the Act.

Since jurisdiction for respondent's common law causes of action was based on the doctrine of pendent jurisdiction, they

were dismissed once the federal cause of action was held to fail to state a cause of action.

The Court of Appeals in a yet unreported decision (see Appendix A, infra, page 19), agreed with the District Court that respondent could not state a Section 10b or Rule 10b-5 claim based on an inability to sell or offer to sell Verit stock, even if his inability was caused by petitioner's fraudulent or deceptive acts. Nor could respondent state a cause of action for the diminished value of the stock that he eventually sold to third persons, since the complaint failed to make any showing that connects any of the alleged fraudulent activities to these sales.

However, the Court of Appeals found that respondent's complaint stated a cause of action for fraud in connection with the original acquisition of Verit stock by

respondent. The Court reasoned that since California law implies a covenant of good faith and fair dealing in every contract, whereby a party will do nothing to injure the right of any other to receive the benefit of the agreement, and each will do everything that the contract presupposes that he will do to bring the bargain to fruition, respondent could not get the full value of his bargain until he could sell his Verit stock. Thus, under these circumstances, petitioner's implied covenant of good faith continued and the exchange contract remained executory, until the restrictions were removed, or until they could have been removed, with the cooperation of Verit. Since the contract was still executory, the alleged fraud was in connection with the purchase or sale of securities within the meaning of Section 10b and Rule 10b-5 and respondent pleaded enough facts to withstand a motion to dismiss.

REASONS FOR GRANTING THE WRIT

I

Certiorari Should Be Granted in Order To Delimit The Scope Of The "In Connection" Requirement Of Rule 10b-5.

Historically, when faced with the problem of deciding how closely related the misconduct must be to the security transaction in order to satisfy the "in connection" requirement of Rule 10b-5, courts either took a strict view and refused jurisdiction when the connection was not direct (c.f. Birnbaum v. Newport Steel Corp., 139 F.2d 461, 463 (2nd Circuit 1952), Cert. Denied 343 U.S. 959 (1952)), or a liberal interpretation of the Rule thus permitting a greater number of suits to be brought under Rule 10b-5. 1 Bromberg, Securities Law: Fraud S.E.C. Rule 10b-5 Section 4.7 (571). Whichever position a court took it did so without guidance from this Court.

Such was the state of the law until this Court's decision in Supt. of Insurance v. Banker's Life and Casualty Company, 404 U.S. 6 (1971). There, faced with the mechanical mode of interpretation and with the strict result it produced in the District and Appellate Courts, this Court reversed the lower courts and substituted instead an open-ended concept of "touching" at pages 12-13, when it said: "The crux of the present case is that Manhattan suffered an injury as a result of deceptive practices touching its sale of securities as an investor."

The consequences of the decision in Banker's Life is still reverberating throughout the lower courts. In the words of Professor Bromberg:

> "While the Court annihilated the restrictions imposed on 'connection' by the lower courts, it

avoided explicitly creating any of its own. By using 'touching' as a synonym, 404 U.S. 12-13, it suggested that 'connection' can be very tenuous indeed. Thus we are left with a very open-ended concept save for limits which might be inferred from some of the phrase-ology, particularly the references to Manhattan 'as an investor'. Given the statutory base for this phrase, it is probably the critical element in delimiting 'connection'.

Even with this clue, trying to devise a test of 'connection' is risky, both because the Court refused to do so and because the situa-tions to which it must apply are so various." 1 Bromberg, Securities Law: Fraud S.E.C. Rule 10b-5 Section 4.7(574)(3).

Since Banker's Life, lower courts have had to deal with the "connection" issue on case by case basis without any guidelines from this Court. This willingness to allow for case by case analysis in this area, is in direct contrast with this Court's unwillingness to allow such development of the law in the purchaser and seller area. In Blue Chip Stamps v. Manor Drug Store, 421 U.S. 723, 44 L.Ed 539, 95 S.Ct. 1917, (1975) after noting that there has been widespread recognition that litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from litigation in general, and after discussing the legislative history of Sections 10b and Rule 10b-5, this Court finally concluded:

> "Were we to agree with the Court of Appeals in this case, we would leave the Birnbaum rule open to endless case-by-case erosion

depending on whether a particular group of plaintiffs were thought by the court in which the issue was being litigated to be sufficiently more discreet than the world of potential purchasers at large to justify an exception. We do not believe that such a shifting and highly fact-oriented disposition of the issue of who may bring a damages claim for violation of Rule 10b-5 is a satisfactory basis for a rule of liability imposed on the conduct of business transactions. Nor is it as consistent as a straightforward application of the Birnbaum rule with the other factors which support the retention of that rule." Blue Chip Stamps v. Manor Drug Store, Supra, page 755.

Despite this Court's refusal to set

guidelines for "connection" in Banker's Life, nonetheless, the "connection" requirement must have some boundaries. Without adequate boundaries lower courts will always be able to search the complex factual situations usually involved in Rule 10b-5 actions and find some "connection" between the alleged misconduct and the purchase and sale of securities, no matter how tenuous it may be. A prime example of the type of abuse possible is the instant case. There the Court of Appeals for the Ninth Circuit found that an implied covenant of good faith and fair dealing kept an otherwise completed stock exchange contract executory and that executory contract provided sufficient "touching" between the alleged misconduct and the securities transaction to satisfy the "connection" requirement. While at least one other court has held that an executory contract satisfies the "connection" requirement, Davis v.

Davis, 526 F.2d 1286, 1290 (5th Cir. 1976), Davis is clearly distinguishable from the case at bar. In Davis, the contract had been entered into but payment had not yet been made pursuant to the contract. The purpose of the alleged scheme was to reduce the amount of the payment due. Thus, the misconduct was more directly related to the transaction than in the instant case. Furthermore, the plaintiff in Davis was only seeking injunctive relief. Historically, the standards for bringing a suit under 10b-5 for injunctive relief have always been more lenient than where money damages are sought.

Thus, the Court of Appeals in the instant case has stretched the "in connection" requirement to an unprecedented length. By its decision, it allows vexatious litigation in the back door after this court in Blue Chip Stamps shut the front door on such suits. The only way

that these types of cases can be stopped, and the case by case erosion of the "in connection" requirement be stopped, is for this Court to provide guidelines for determining the scope of the "in connection" requirement.

CONCLUSION

For these reasons, a Writ of Certiorari should issue to review the judgment and opinion of the Court of Appeals for the Ninth Circuit.

Respectfully submitted,

By _____

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APPENDIX A

Opinion of the United States Court of Appeals for the Ninth Circuit

Entered May 25, 1976

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

JOE OHASHI, Plaintiff and Appellant, vs. VERIT INDUSTRIES, a corporation, BERJ HAGOPIAN, EDWARD L. CLABAUGH, MARVIN COBB, ROBERT O. MARSHALL, and UNITED STATES STOCK TRANSFER CORPORATION, a corporation, Defendants and Appellees.	No. 74-2027 OPINION

Appeal from the United States District Court for the Central District of California

Before: BARNES and HUFSTEDLER, Circuit Judges, and SKOPIL,* District Judge

*Honorable Otto Skopil, Jr., District of Oregon, sitting by designation.

HUFSTEDLER, Circuit Judge:

Ohashi appeals from the dismissal of his damages claims for failure to state a claim for relief under the federal securities laws (Securities Exchange Act of 1934, §10b, 15 U.S.C. §78j(b), and SEC Rule 10b-5, 17 C.F.R. §240.10b-5) and for want of jurisdiction of the common law tort claims. The defendants are Verit Industries, a corporation ("Verit"); three of its directors and officers, Hagopian, Clabaugh, and Cobb; United States Stock Transfer Corporation (Stock Transfer") and its president, Marshall.

The district court held that the Birnbaum rule (Birnbaum v. Newport Steel Corp. (2d Cir. 1952) 193 F.2d 461) barred relief under Section 10b and Rule 10b-5; with the demise of the federal claim, the pendent state claims were also dismissed.

We agree with the district court's disposition of all theories of federal

securities relief, save one: Verit's fraud was alleged to have impaired the consideration for the exchange of securities after the securities had been transferred to Ohashi, but while the contract was still executory. That alleged fraud was "in connection with the purchase or sale of any securities" within the meaning of Section 10b and Rule 10b-5. The complaint adequately pleaded enough facts to withstand the motion to dismiss filed by Verit, Hagopian, Clabaugh, and Cobb on this theory.

In substance, the pleadings recited the following facts, the truth of which is presently assumed. Ohashi was the majority stockholder of Commerce-Pacific, Inc. ("Commerce") when Tanger Industries (now Verit) undertook to acquire Commerce in 1968. Ohashi's Commerce stock was then worth about $300,000. As a part of the acquisition agreement of May 13, 1968,

Ohashi exchanged his Commerce stock for shares of Verit's one dollar par common stock. Although Verit's common stock was being publicly traded, the shares issued to Ohashi were not registered with the SEC; that block of stock was issued pursuant to the private offering exemption of Section 4(2) of the Securities Act of 1933. (15 U.S.C. §77d(2).) An integral part of the exchange agreement was the provision requiring Ohashi to execute an "Investment Letter" wherein he agreed not to transfer his Verit shares until (1) he had given a detailed statement of facts surrounding the proposed transfer to Verit, and had received a written opinion from Verit's counsel stating that the proposed transaction would not violate federal securities regulations, or (2) he had received a "no action" letter from the SEC. The following legend and transfer restriction was placed on his shares:

> "No sale, offer to sell or transfer of the shares represented by this certificate shall be made unless a registration statement under the Federal Securities Act of 1933, as amended with respect to such shares is then in effect or an exemption from the registration requirements of such Act is then in fact applicable to such shares."

Verit instructed its transfer agent, Stock Transfer, that none of Ohashi's stock could be sold, offered for sale, or transferred without Verit's express authorization.

From December, 1970, until January, 1972, Ohashi repeatedly inquired about removal of the restrictions and was falsely assued by the Verit defendants that removal was imminent or that they were taking appropriate steps in that direction. In November, 1971, Ohashi sent Verit a "no action" letter from the SEC. The Verit defendants continued their inaction and false assurances of their intent to perform. When relief was still not forth-

coming, Ohashi was coercively induced to enter an escrow agreement in January, 1972, whereby he agreed to removal of the restrictions on a piecemeal basis. Ohashi avers that all of these misrepresentations were made to further a conspiracy among the defendants to keep Ohashi's stock off the market and thereby to limit the "public float" of Verit's stock for the purpose of artificially raising the price of the publicly traded stock. The restrictions were removed on January 12, 1972, but, by that time, the defendants' manipulations of publicly traded Verit stock were under investigation which culminated in the SEC's suspending trading in Verit on May 18, 1972.

During the period from August 1, 1972 to October 31, 1973, Ohashi sold about one-third of his Verit stock to third persons. At the time he acquired his stock, Verit common stock was trading at $14 per share, but when he sold it, the price had fallen

to $1.50 per share.

For claimed fraud in connection with the purchase and sale of securities, he sought compensatory and punitive damages and attorney's fees.

The district court correctly held that Ohashi could not state a Section 10b or Rule 10b-5 claim based on his inability to sell or offer to sell his Verit stock to third persons, even if his inability was caused by defendants' fraudulent or deceptive acts. As to these nonsales, Ohashi was neither a buyer nor a seller of securities, and the Birnbaum fule foreclosed his claim. (Blue Chip Stamps v. Manor Drug Stores (1975) 421 U.S. 723.)

Likewise correct was the dismissal of his Section 10(b) and Rule 10b-5 claim based on the diminished value of the stock that he sold to third persons. He was a seller of that stock, but the complaint fails to make any showing that connects

any of the alleged fraudulent activities to these sales. The deceptive conduct involving his shares occurred between June 1, 1971, when the restrictions were supposed to be removed and January 12, 1972, when the restrictions were removed. His sales did not occur until August 1, 1972, and thereafter. He did not claim that he sold his shares for less than their market value at the time of the sales. Rather, his theory is that the market value of the stock would have been much higher if the value of all of the Verit stock, including his own, had not been impaired by the wrongful conduct that had occurred before January 12, 1972. Recovery on this theory is also foreclosed by the Birnbaum rule. (Birnbaum v. Newport Steel Corporation, supra.)

As the Supreme Court explained in Blue Chip Stamps, supra:

"Three principal classes of potential plaintiffs are presently barred by the Birnbaum rule . . . Third are shareholders, creditors, and perhaps others related to an issuer who suffered loss in the value of their investment due to corporate or insider activities in connection with the purchase or sale of securities which violate Rule 10b-5. It has been held that shareholder members of the . . . third of these classes may frequently be able to circumvent the Birnbaum limitation through bringing a derivative action on behalf of the corporate issuer if the latter is itself a purchaser or seller of securities." (Blue Chip Stamps v. Manor Drug Stores, supra, 421 U.S. at 738-39.)

Ohashi is within the "third class" in respect to his own sales, and he cannot circumvent Birnbaum in this action. It does not purport to be a derivative suit.

One theory remains: Was there fraud "in connection with" the Verit stock that he acquired in exchange for his Commerce stock?

If the exchange had been fully executed upon Verit's issuance of its stock to him and his transfer to Verit of his

Commerce stock, the answer would be "No." Ohashi does not contend that the defendants fraudulently incuded the exchange or that any fraud tainted the initial restrictions placed upon his Verit stock. The fraud of which he complains occurred after the exchange; the subsequent illegal conduct was not in connection with the inducement nor concurrently with the exchange.

However, if the contract by which Ohashi acquired Verit stock was still executory when the fraudulent activities occurred and if those acts affected the unperformed part of the bargain, the fraud may be "in connection with the sale or exchange of any securities." If the contract was still executory, a sufficient contractual relationship existed. It is clear by our prior decision in Mount Clemens Industries, Inc. v. Bell, 464 F.2d 339 (9th Cir. 1972), that "the existence of a contractual relationship between the

parties [is an essential element to elevate] the plaintiffs to the status of statutory purchasers or sellers." (Id. at 345.) We turn to the law of California, where the contract was made, to decide whether the contract was executory and then to federal law to ascertain whether the alleged fraud was in connection with the exchange of securities.

Under California law, every contract contains an implied covenant of good faith and fair dealing whereby no party will do anything to injure the right of any other to receive the benefits of the agreement, and each will do everything that the contract presupposes that he will do to bring the bargain to fruition. (Crail v. Blakely (1973) 8 Cal. 3d 744, 749-50, 106 Cal. Rptr. 187, 191; Berkeley Lawn Bowling Club v. City of Berkeley (1st Dist. 1974) 42 Cal. App. 3d 280, 286-87, 116 Cal. Rptr. 762,766.) The exchange contract

presupposed that Ohashi could not receive the full benefit of his bargain until the transfer restrictions were lifted. But, Verit could not permit removal until a transfer of Ohashi's Verit stock would not place it in danger of violating the Securities Act of 1933. Under the private offering exemption, the stock issued to Ohashi was not registered, and if the terms of the exemption were not met, Verit would have been in violation of the Act. The removal of the restrictions could not legally have occurred for a substantial period of time; it was anticipated that the condition would not be met until 1971. Although Verit did not have any express contractual duty to remove the restrictions, its cooperation was necessary to permit removal as soon as feasible. Under these circumstances, Verit's implied covenant of good faith continued and the exchange contract remained executory (see 1 B. Witkin,

Summary of California Law, §6 (8th ed. 1973), but see 1 Williston on Contracts, §14 (3d ed. 1957)) until the restrictions were removed, or until they could have been removed with the cooperation of Verit. (Cf. Riess v. Murchison (9th Cir. 1974) 503 F2d 999, 1011-1012.) Thus, the exchange contract will still executory at least until sometime in 1971, and, perhaps, later.

The alleged false representations by Verit, acting through Hagopian, Clabaugh and Cobb relating to the acts done by Verit to remove the restrictions and with respect to Verit's intentions in acting to remove them were made between December, 1970, and January 12, 1972. At this stage of the pleading, we cannot ascertain whether all of the misrepresentations were made while the contract was alive, but some of them were made before the restrictions were or could have been removed.

Not every failure to perform a contractual covenant in a contract to sell or exchange securities can become a basis for a claim that a defaulting party has employed a "device, scheme, or artifice to defraud" within the meaning of Rule 10b-5, let alone a claim for common law fraud.[1/] "[W]hether there is actionable fraud or a mere breach of contract depends on the facts and circumstances developed at the trial or on motion for summary judgment." (A.T. Brod & Co. v. Perlow (2d Cir. 1967) 375 F.2d 393, 398.) Especially is this observation true in a situation like this one in which it is alleged that active misrepresentations were made to Ohashi and marked manipulations were wrongfully undertaken as an accompaniment to nonperformance of the implied covenant. (Cf. Allico

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[1/] A.L.I. Restatement (Second) Torts §§ 525-45A (Tentative Drafts 10, 1964 &11, 1965).

National Corp. v. Amalgamated Meat Cutters and Butcher Workmen of North America (7th Cir. 1968) 397 F.2d 727, 1 A. Bromberg, Securities Law: Fraud, §4.6(230) at 82.1 (1975).)

The alleged misrepresentations of Verit and Verit's named officers and directors were made in connection with the still executory covenant of good faith and fair dealing in the 1968 exchange agreement. These averments together with the asserted detriment to Ohashi were enough to withstand Verit's and its directors' and officers' motion to dismiss Ohashi's Section 10(b) and Rule 10b-5 claim.

However, the defendants' attack upon the complaint for deficiencies in the damage averments is well taken. As presently drafted, the complaint does not specifically relate the alleged fraud in connection with the 1968 exchange to identified out of-pocket loss suffered by him

as a consequence of the fraud. (Estate Counseling Service Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc. (10th Cir. 1962) 303 F.2d 527. See Sackett v. Beaman (9th Cir. 1968) 399 F.2d 884, 891.) We have no reason to believe at this time that these defects cannot be cured by amendment on remand.

Nothing we have said saves any federal claim against United States Stock Transfer Corporation or its president, Robert O. Marshall. These defendants were not parties to the exchange agreement, and no act of theirs is alleged that tied them into any deception or unfair dealing in connection with that exchange. The federal claim and the pendent state claims were correctly dismissed against them.

The order dismissing the complaint against United States Stock Transfer Corporation and Robert O. Marshal is affirmed, and they shall have their costs on appeal.

The order dismissing the appeal against Verit, and the individually named officers and directors of Verit is affirmed in part, reversed in part, and remanded to the district court for further proceedings consistent with the views herein expressed.[2/] These parties and Ohashi shall each bear their own costs on appeal.

[2/] Because we find the securities law claim does not fail to state a claim, the district court retains its pendent jurisdiction over the state law claims against Verit and its officers and directors.

SKOPIL, District Judge, Dissenting:

I must respectfully dissent.

The existence of a contractual relationship is crucial to plaintiff's federal cause of action. As the majority recognizes, its decision is correct only if the 1968 exchange contract was still executory when the alleged fraud occurred. Clearly, as express agreement by Verit to remove the stock transfer restrictions would have rendered the contract executory. But the contract contained no such agreement. The express terms of the contract had already been fully performed when the alleged fraud occurred. Even acknowledging that every contract contains an implied covenant of good faith and fair dealing, I do not believe that any implied duty sufficient to make the contract executory exists under the facts of this case.

I would affirm the decision of the district court.

APPENDIX B

Opinion of the United States District Court for the Central District of California

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

JOE OHASHI, Plaintiff, vs. VERIT INDUSTRIES, Inc., et al., Defendants.	No. 73-2701-JWC MEMORANDUM GRANTING DEFENDANTS' MOTION TO DISMISS THE COMPLAINT.
ROBERT O. MARSHALL, Cross Claimant, vs. VERIT INDUSTRIES, etc., et al., Cross Defendants.	

This is a security fraud case brought by a stockholder against the issuing corporation and its officers. The complaint

consists of 13 counts. The first through the third and sixth through the eighth counts allege common law fraud under California law. The fourth, fifth and ninth counts appear to allege common law conversion. The tenth and twelfth counts purport to accrue under common law rules with respect to civil conspiracy, while the thirteenth count alleges common law disparagement (i.e., slander of title close). Only one, the eleventh claim attempts to state a federal claim for relief.

Since there is no diversity alleged, plaintiff is apparently relying upon the doctrine of pendent jurisdiction to maintain his twelve state claims in this court.

Turning our attention, then, the plaintiff's eleventh claim, plaintiff seeks relief for an alleged violation of §10(b) of the Securities Exchange Act of 1934 [15 U.S.C. §78j(b) and Rule 10b-5, 17 C.F.R. 240.10b-5].

In general, the complaint alleges that in August of 1968 the plaintiff, Ohashi, became the owner, individually and as custodian for certain of his unidentified children, of 7,784 shares of Verit stock. These shares were subject to a legend restriction, which prohibited sale or transfer until they were registered with the S.E.C. or exempted from registration. Plaintiff further alleges that between February 1969 and October 1971 he acquired an additional 16,141 shares as a result of a stock split and two stock dividends. In December 1970, the plaintiff decided to sell a portion of his shares, but he alleges he was prevented from doing so because of the restrictions on the stock.

The alleged misconduct of defendants is stated in a variety of ways throughout the complaint. However, the thrust of the argument is that although the defendants represented that they would obtain a

release of the restrictions on the stock, and although they had a reasonable time within which to do so, they have failed to take the necessary steps to bring it about.

The plaintiff's eleventh claim fails to state a cause of action, for it fails to allege facts from it would appear that the plaintiff is either a purchaser or a seller within the meaning of the Act.

Although plaintiff asserts that he would not have purchased the stock except for the defendants' representations, the allegations of fact indicate that the alleged misrepresentations were first made to the plaintiff in December 1970, long after his original purchase of the stock. He therefore is not a purchaser.

The plaintiff also alleges that he is a defrauded seller of securities in that he was induced not to sell the stock because of the representations. The plaintiff relies on Mount Clemens Industries,

Inc. v. Bell, 464 F.2d 399 (9th Cir. 1972). This case holds that while ordinarily a stockholder who is persuaded not to sell his stock is not a seller within the meaning of the Act, if he has been induced to enter into an agreement to either purchase or sell securities, then he is either a purchaser of a seller within the statutory definition. But here there is no such agreement. Plaintiff refers vaguely to some contractual right which he has to sell the stock on the open market, but this is a far cry from an agreement to buy and sell stock as would make the plaintiff a buyer or seller within themeaning of Rule 10b-5.

Actually, the conduct of which the plaintiff complains is in the nature of a breach of contract in that the defendants have failed to do that which they were obligated to do, either by express or implied agreement, to clear up the restriction endorsed on the stock.

The facts alleged simply do not fit the statutory concept of a Rule 10b-5 violation. Defendants' motion to dismiss is therefore granted.

DATED: April 4, 1974.

JESSE W. CURTIS
United States District
Judge

No. 76-254

Supreme Court, U. S.
FILED
NOV 15 1976
MICHAEL RODAK, JR., CLERK

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1976

VERIT INDUSTRIES and MARVIN COBB,

Petitioners,

vs.

JOE OHASHI

Respondent.

Answer to Petition for Writ of Certiorari

To the United States Court of Appeals

For the Ninth Circuit

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IN THE SUPREME COURT OF THE UNITED STATES

October Term 1976

No. 76-254

VERIT INDUSTRIES and MARVIN COBB,

Petitioners,

vs.

JOE OHASHI

Respondent.

ANSWER TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

To the Honorable, the Chief Justice, and the Associate Justices of the Supreme Court of the United States,

The respondent, JOE OHASHI, answers the Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit and objects to the granting of such petition on the following grounds:

1. The Order of Judgment of the Court of Appeals of the Ninth Circuit, in the instant case

did not stretch the "in connection with" requirement of Birnbaum v. Newport Steel Corp., 139 F.2nd 461, 463 (2nd Cir. 1952), Cert.Denied. 343 U.S. 959 (1952) and of Blue Chip Stamps v. Manor Drug Store, 421 U.S. 723, 44 L.Ed. 539, 95 S. Ct. 1917, (1975) to an "unprecedented length" as stated in the petitioner's brief to this Court. The decission of the Court of Appeals for the Ninth Circuit in the instant case did not ignore the holding of the Blue Chip Stamps Case as enunciated by this Court.

2. The Order of Judgment of the Court of Appeals for the Ninth Circuit interpreted the statutory definition of a "sale" as such term is defined under the Securities Exchange Act of 1934 ((15 U.S.C. Sec. 78c(a)(14)) and as such correctly found that the fraudulent activities complained of by the respondent in his complaint were activities which occurred in connection with the sale or exchange of securities.

3. The petitioners have not set forth any new points not already considered by the Ninth Circuit Court of Appeals. There is no evidence in the decision of the Ninth Circuit in the instant

case of an expansion of the scope of the "in connection with" requirement of Rule 10b-5 as stated by this Court in the Blue Chip Stamps case.

For these reasons the respondent requests that the Petitioners' request for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit be denied.

STATEMENT OF THE CASE

The respondent incorporates herein the Statement of the Case of the petitioner, P. 6-7 of the petitioners' petition.

REASONS FOR NOT GRANTING THE WRIT

I.

Certiorari Should Not Be Granted as there is no showing that the decision of the Ninth Circuit Court of Appeals in the instant case enlarged the scope of the "in connection with" requirement of Rule 10b-5 as stated by this Court in Blue Chip Stamps v. Manor Drug Store, supra Pg. 1.

The Ninth Circuit Court of Appeals in the

instant case found that the respondent's complaint stated a cause of action for fraud in connection with the original acquisition of Verit stock by the respondent. The Court reasoned that since California law implies a covenant of good faith and fair dealing in every contract, whereby a party will do nothing to injure the right of another to receive the benefit of the agreement, and each will do everything that the contract presupposes that he will do to bring the bargain to fruition, the respondent could not get the full value of his bargain until the restrictions on sale were removed from his stock by Verit. Thus, under the facts and circumstances of this case and as plead in the herein complaint, petitioners' implied covenant of good faith continued and the exchange contract remained executory, until the restrictions were removed with the cooperation of Verit. Since the contract was still executory at the time the alleged fraud occurred, the alleged fraud occurred in connection with the sale of securities within the meaning of Section 10b and Rule 10b-5 and the respondent's complaint pleads

enough facts to withstand a motion to dismiss.

The fraud upon which the respondent complains occurred after the exchange but during the executory period of the exchange.

The respondent's complaint pleads that the contract by which the respondent acquired his Verit stock ("the Exchange Agreement") was still executory when the fraudulent activities occurred and the fraudulent activities effected the unperformed part of the bargain and that therefore the fraud was in connection with the sale or exchange of securities.

The Ninth Circuit Court of Appeals in the instant case found that the Exchange Agreement was still executory, and that a sufficient contractual relationship existed. The existence of a contractual relationship between the parties is an essential element to elevate the respondent to the status of a statutory seller under the Securities Exchange Act of 1934. Mount Clemens Industries, Inc. v. Bell, 464 F.2nd 339 (9th Cir. 1972). The Ninth Circuit Court of Appeals concluded that the respondent was a statutory seller under the

Securities Exchange Act of 1934 (U.S.C. Section 78c(a)(14). In Section 3(a)(14) of the Securities Exchange Act of 1934 a "sale" is deemed to encompass "any contract to sell or otherwise dispose of." The Exchange Agreement between the petitioner and the respondent contemplates the eventual disposition of the respondent's shares of Verit by sale or otherwise. In fact, any disposition of the respondent's shares is dependent upon the approval of the petitioner. This "approval" requirement is set out as part of an existing contractual relationship found in the Exchange Agreement between the parties which elevates the respondent to the status of a statutory seller.

The Ninth Circuit Court of Appeals then turned to the law of California, where the contract was made, to decide whether the contract was executory and then to federal law (Blue Chip Stamps v. Manor Drugs, supra Pg. 1) to ascertain whether the alleged fraud was <u>in connection with</u> the exchange of securities.

The Ninth Circuit Court of Appeals correctly found that every contract under California law

contains an implied covenant of good faith and fair dealing whereby no party will do anything to injure the right of any other to receive the benefits of the agreement, and each will do everything that the contract presupposes that he will do to bring the bargain to fruition. The Exchange Agreement presupposed that the respondent could not receive the benefit of his bargain until the transfer restrictions were lifted by Verit. The cooperation of Verit was necessary to permit removal of the restrictions. Under these circumstances the Ninth Circuit Court of Appeals held that Verit's implied covenant of good faith continued throughout the period of the Exchange Agreement and the Exchange Agreement remained executory until the restrictions were removed with the cooperation of Verit.

The Ninth Circuit Court of Appeals found that the Complaint alleged fraudulent activities of Verit and Verit's named officers and directors <u>in connection with</u> the still executory covenant of good faith and fair dealing of the Exchange Agreement. The aveerments in the complaint

together with the asserted detriment to Ohashi the Ninth Circuit stated was enough to withstand Verit and it's directors and officers Motion to Dismiss under Section 10b and Rule 10b-5 of the Securities Exchange Act of 1934.

II.

The Ninth Circuit Court of Appeals in the instant case did not stretch the "in connection with" requirement of the Blue Chip Stamps case to an unprecedented length as stated by the petitioners. It's decision follows the previous holdings of this court and does nothing to expand upon the law as stated by this Court in the Blue Chip Stamps case. In fact the author of the Ninth Circuit Court of Appeals decision in the underlying case is the same Judge Hufstedler whose dissenting opinion in Blue Chip Stamps v. Manor Drug Stores, 492 F.2d 136 (9th Cir. 1973) enunciated the same holding of this Court in Blue Chip Stamps, supra Pg. 1.

The decision of Judge Hufstedler in the underlying Ninth Circuit Court of Appeals decision in no way, shape or form errodes the "in connection

with" requirement as enunciated by this Court in the Blue Chip Stamps case. The decision of Judge Hufstedler of the Ninth Circuit Court of Appeals does not open the door to vexatious litigation as urged by petitioner but merely interprets the facts of the underlining Complaint with the existing case law as previously enunciated by this Court and the definition of "sale" in Section 3(a)(14) of the Securities Exchange Act of 1934.

CONCLUSION

For these reasons a Writ of Certiorari should not be granted to review the judgment of the Court of Appeals for the Ninth Circuit in the instant case.

Respectfully submitted,

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IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1976

VERIT INDUSTRIES and MARVIN COBB, Petitioners, vs. JOE OHASHI	)	Case No. 76-254 AFFIDAVIT OF MAILING

I, JANIS CROUCH, say:

I am a citizen of the United States and a resident of the County of Los Angeles; I am over the age of eighteen years and not a party to the above-entitled action; my business address is 1901 Avenue of the Stars, Suite 1630, Los Angeles, California.

On November 10, 1976, I served a copy of the ANSWER TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT filed in the within action on the interested parties to said action, by placing a true copy thereof enclosed in a sealed envelope with postage thereon fully prepaid, in the United States mail at Los Angeles, California, addressed as follows:

SUPREME COURT OF THE UNITED STATES
Washington, D.C.

EDWARD L. CLABAUGH
1901 Avenue of the Stars
Los Angeles, CA 90067

LEDERER & LEVY
433 N. Camden Drive, Ste. 600
Beverly Hills, CA 90210

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1888 Century Park East
Los Angeles, CA 90067

I declare under penalty of perjury that the foregoing is true and correct.

Executed on November 10, 1976, at Los Angeles, California.

JANIS CROUCH